The Free Market

"If you don't create a free market, a black market will emerge"

NEWSLETTER OF THE LITHUANIAN FREE MARKET INSTITUTE - www.freema.org/Newsletter/index.phtml

NEWS

LFMI announces a writing contest "Freedom Studies"

In pursuit of its educational activities, LFMI has announced a writing contest "Freedom Studies," which is aimed to enhance the understanding of social and economic laws in the life of the society. LFMI hopes that this contest will develop a tradition of teaching freedom as a subject that requires profound public understanding.

The contest is designed for university students and self-studying people who are above 17 years of age and do not hold a PhD. Contestants will have to submit a course paper dedicated to the issue of social and economic laws of the society and their workings in the economy, law, morals and other spheres. LFMI believes that by writing this paper, students will be encouraged to analyse how economic and social laws function in the society, to understand peoples' motives in social-economic activities, and to perceive that the variety of people's aims and values does not disturb but, quite the contrary, maintains a smooth coexistence of the society.

The winners of the contest will be announced in September of 2004 and will be awarded by cash prizes. The best papers will be posted on LFMI's website in Lithuanian.

This is not the first initiative by LFMI in co-operating with the studying yougt. For a fourth year, LFMI offers a semester-long university course "Capitalism and Freedom," which is aimed to instil in students self-conscious liberal thinking through the study and internalization of sound social and economic ideas. This course was taught at a number of faculties of Vilnius University, the Institute of International Relations and Political Sciences and the International School of Management.

More than one-third of people in Lithuania know LFMI

Seeking to find out to what extent the Lithuanian society is familiar with the Lithuanian Free Market Institute (LFMI) and its activities, as well as recommended by the Board of LFMI, the institute commissioned a survey of public opinion in Lithuania which was conducted by company *TNS Gallup* in October 2003. The survey was carried out on the basis of an Omnibus poll. The number of respondents polled totalled 518. The poll represents the residents of the entire country at the age between 15 and 74 years.

The survey showed that more than one-third (37 percent) of Lithuanian residents know or have heard about the Lithuanian Free Market Institute. As expected, LFMI is known more widely among senior (40 to 49 years) people (53 percent of those polled), people with university education (80 percent), employed people (48 percent), people with higher income (62 percent), and residents of Vilnius, the capital, and Kaunas, the second largest city (49 percent).

Asked about what the Lithuanian Free Market Institute represents, more than half (57 percent) of the respondents who knew or heard of LFMI answered that this organisation stands for the ideas of the free market. Around one-third of the respondents think that LFMI represents the interests of consumers (33 percent), all Lithuanian citizens (32 percent), and Lithuanian companies (30 percent). When answering this question, the participants of the poll could indicate more than one answer.

According to the survey, two-thirds (69 percent) of those who know or have heard about LFMI entirely or partly trust this organisation as regards the informing of the society about key economic issues. A similar share (70 percent) of the respondents trusts societal non-political organisations in general. The level of confidence in other institutions goes down as follows: the Presidency (62 percent), the Government (55 percent), trade unions (54 percent), business organisations (48 percent) and the Parliament (45 percent). The political parties are trusted the least (24 percent).

Asked about the organisation type of LFMI, most of those who know or heard of LFMI chose the right answer – that LFMI is a non-profit non-government organization. None of the respondents said that LFMI is a political organisation.

LFMI analyses employment regulations

On 18 December, 2003, LFMI held a press conference "Work Councils: From a Good Idea to Unapt Implementation" to present a position on, and proposals for, a draft law on work councils currently debated by the Parliament. Representatives from LFMI and business associations pointed out at the press conference that work councils were a welcome and needed institution for a balanced representation of employees but, they argued, certain provisions of the draft law can act as a drag on the establishment of work councils.

They spotlighted that the draft law discriminates work councils against trade unions as it states that a work council shall be eliminated once a trade union is established in the organisation. Moreover, the draft law lays down an overly bureaucratic procedure for setting of a work council and places a financial burden on the employer who, according to the draft law, will have to cover the costs of the work and training of the representatives of the work council. The draft law also stipulates that the representatives of the work council will have to be furnished with the organisation's confidential information.

LFMI and business representatives highlighted that the said provisions would be disastrous to many of the companies in Lithuania, while the duty to provide secret information may be hazardous even to the strongest companies. They called for revision of the draft law which is to be passed by the Parliament in the coming month.

Taxation of NGOs profit would retard the development of the third sector

Working on the regulation of the NGO sector, LFMI has analysed draft amendments to the law on profit tax, according to which, profits of non-profit organisations gained from commercial activities would be taxed. LFMI pointed out that the amendment had been drafted without taking into account the specific nature and activities of public non-profit institutions, the most popular form of non-profit organisations. Taxing the profits of non-profit organisations (these profits have to be used to finance their own activities anyway) would stifle the development and activity of the third sector which would have negative effects on the democracy and integration processes in Lithuania.

LFMI submitted recommendations on the draft amendments to the Parliament in October 2003. This legal document is to be passed in the coming month.

A debate on pension reform and its future

On November 12, 2003, LFMI hosted a discussion "Pension Reform and Its Prospects," which was designed to enlighten the public about the possibilities and benefits of the funded pension system and private pension funds and to debate the prospects of the pension reform in Lithuania. The event aimed at bringing for the public discussion the roadblocks that impede the implementation of the reform and to propose measures that would eliminate them. The debate drew participants from state supervisory institutions, pension funds, the Ministry of Social Security and Labour, and LFMI.

Representatives from private pension funds spoke at the event that the pension reform was taking place similarly to their expectations: people in Lithuania were quite active in choosing private funded pension system and that the most popular were diversified pension funds. They also pointed out that privately funded pension system is not a measure to make a fortune but a way to save for the future.

It was also highlighted during the debate that Lithuania had chosen the right scheme for pension reform but its scope was too small to solve the anticipated problems in the state insurance system, to create conditions for the acceptable growth of future pensions, and to ensure the success of the reform. According to policy analysts of LFMI, Lithuania's economic and demographic conditions at present are favourable enough to increase, in the short-run, the size of social security contribution which is being channelled into private pension funds. This decision, they argued, depends only on the political will.

Business and government representatives discussed "the unknowns" in the EU law

On 4 December, 2003, LFMI, in co-operation with the Friedrich Naumann Foundation and companies *Ernst & Young Baltic* and *Coca-Cola Bottlers Lietuva*, held a conference "Ready for the European Union accession? Getting into the details of implementing EU norms." The aim of the event was to provide an opportunity for Lithuanian entrepreneurs to discuss unclear issues regarding the regulations of the European Union and practical implementation of the EU regulatory norms, as well as to discuss what difficulties Lithuanian business people still faced as the membership in the EU was approaching. The conference drew participants from the business sector and state institutions that are responsible for the implementation of the EU norms.

Although the European Commission has recognised Lithuania as the one of the best candidate countries in transposing the EU norms into the national laws, recently there has been an apparent gap between these optimistic official evaluations and Lithuanian entrepreneurs' fears about how specifically the legal acts regulating individual business sectors will change. For this reason, LFMI organised this conference to give an opportunity for business representatives to learn about the coming changes as regards EU membership, and for the state institutions to present the information that is essential to the business community.

It was concluded at the event that the most serious challenges for the Lithuanian companies will be to prepare for competing in the common market and for operating in a changing environment. The basic challenges that the state institutions will come up with were enumerated as proper representation of Lithuania's interests in the EU and the implementation of the decisions by the EU.

Tobacco control tightened more rigidly than in the EU

Pursuing the activities regarding market regulations, in October 2003 LFMI made an analysis of a draft law on tobacco control and submitted to the Parliament a package of policy proposals on the testing of, and trade in, tobacco products, protection from second-hand smoke and the economic sanctions laid down in the draft law.

LFMI concluded that the EU requirements had been inaccurately transposed into the proposed draft law: provisions regarding the testing of tobacco products and the dissemination of such results constrained companies more than the EU law. Moreover, the draft law stipulated unjustified restrictions on tobacco manufacturing, trade and consumption that could have negative results on tobacco business, on an effective implementation of the ban to sell tobacco products to children and adolescents and on the adults' possibilities to choose and acquire tobacco products. Drawing on these arguments, LFMI called for revision of the draft law, for accurate transposing of the EU provisions and for revoking of the said restrictions on tobacco trade and consumption. The Parliament passed the Law on Tobacco Control in the end of 2003; however, LFMI's recommendations were not enshrined in it.

LFMI studies the Lisbon agenda's impact on Lithuania

LFMI has completed a study "Evaluation of the Lisbon agenda of the European Union and its impact on Lithuania," which introduces the Lisbon strategy, its main goals and methods of implementation, and research methodology. The main parts of the study are devoted to the analysis of the general goals and specific targets of the Lisbon strategy in the areas of economic and social policies, their relevance, coherence and the potential impact on Lithuania are assessed. Further on, the conclusions of the analysis and recommendations are provided.

This work is the first significant input to the debate in Lithuania about topical issues of the EU economic and institutional reforms. The authors of this study hope that this research will provide analytical background for formulating Lithuania's position and for informing the public about EU integration and its impact on Lithuania. The study will be disseminated among relevant state institutions and the public at large.

The LFMI's study was contracted by the European Committee under the Government of Lithuania within the framework of the Programme of assessing economic and social impact of Lithuania's accession into the EU, negotiations with the EU and coordination of Lithuania's participation in the work of EU institutions. The study was co-financed by the local pre-accession assistance program of Danish Ministry of Foreign Affairs.

An English summary of the study can be downloaded at http://www.freema.org/Projects/Lisbon.phtml.

LFMI completes a project on the information society

LFMI has completed a project joint project "Factors and Impacts in the Information Society: a Prospective analysis in the candidate countries." Its goal was to make an in-depth analysis of challenges and potentialities related with the EU enlargement by identifying technological, economic, political and social drivers and their impact on science and technology policy, competitiveness and employment in the wider Union over a ten-year horizon.

A contracting authority of this project was the Institute of Prospective Technological Studies, Seville, one of the seven institutes of the Joint Research Centre of the European Commission. Its main mission is to provide prospective analyses in support of the EU's policy making-process. Thirteen candidate countries were taking part in this project; Lithuania was represented by the Lithuanian Free Market Institute. As a result if this project, 13 national monographs were developed. They will be incorporated into an integrating and prospective report about the future outlook for the information society in the candidate countries and the enlarged EU. The report will be conducted by the International Centre for Economic Growth, Budapest.

LFMI implements a new project

In October 2003 LFMI launched a new project which aims at analysing the laws in Lithuania that regulate export, import, and transit procedures in order to evaluate whether they conform with the articles 28-30 of EC Treaty. According to these articles, no quantitative restrictions on export and import and no measures having equivalent effect can be imposed as regards the trade among the EU countries.

Within the framework of the project, LFMI will review and evaluate the laws of the Republic of Lithuania on non-tariff barriers, define their compatibility with the EU legal norms and propose their revisions. LFMI will also evaluate the norms of non-tariff regulation that are set in the laws of the Republic of Lithuania to determine whether they can be compatible with the articles 28-30 of the EC Treaty.

The project will be completed in February 2004. LFMI won this tender organised by the Ministry of Economy.

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FEATURE

In the following article LFMI's Vice-president Ruta Vainiene speaks about corporate investments exempted from the profit tax - a tax rule that was revoked some time ago in Lithuania, and how this rule is being revived in other forms in the life of people in Lithuania, and which of the two forms is fair and which is not.

The article was printed in the specialised weekly 'Mokesciu zinios' (Tax News) on November 11, 2003.

Good Ideas Don't Die

By Ruta Vainiene, Vice-president, LFMI

Business community still remembers the time when, according to the law, investments, or the purchase of long-term material assets, were not taxed. This taxpayer-friendly rule of exempting investments from profit tax did not please bureaucrats and politicians. They believed it was too generous for the taxpayers, as they could invest without paying taxes. There were complaints that this rule was being abused, and cars and household goods bought by companies called suspicion. Of course, a clever bureaucrat should understand that whatever is good for a taxpayer should be good for the state. For instance, the boom of tax-exempt investments has undoubtedly contributed significantly to the current growth of gross domestic product that is beneficial for the most to the entire state. But a wide mindset is not an asset of everyone; that's why this taxpayer-friendly rule was like a thorn in the side, bothering those state officials who counted budget revenues. Because every litas which goes into the taxpayer's pocket is a litas that the budget did not receive today, and the staff counting the budget don't tend to think about tomorrow, because they are implementing a plan that is an annual plan. Indeed, why would one go through that extra trouble of defending this non-traditional taxation from the bureaucrats of the European Union who also dream about bringing their competitors down? Drawing on the European integration rhetoric, the European practice and other political instruments, the rule of tax-exempted investments has been abolished.

But good ideas do not die. Forbidden, erased, abolished, they put their head up and strive for life. When they are not allowed to exist in their usual and convenient form, they look for new forms and a new body. Currently, the Lithuanian Law on Personal Income Tax is going to become a new shelter of tax-exempted investments. This Law allows not to tax, up to a certain amount, two types of personal investments – costs for education and interest rates on housing loans. The deduction of life insurance premiums and pension contributions laid down in the Law is not an exemption of these expenses from taxation: it is postponing these taxes until the time in the future when the benefits are paid out. The deduction of expenses from personal income is not typical of this tax in Lithuania. Personal income, after deducting the non-taxable minimum and insurance contributions, were taxed in full, without any other deductions. Why? It is more convenient because unlike businesses, people do no accounting, have no bureaucratic obligations to declare income and expenses, collect no receipts and so on. It used to be so, but it's not going to remain so anymore. Personal income tax is getting similar to the corporate profit tax. But not in terms of the rate what is most saddening,[*] but in terms of the bureaucracy imposed that an individual willing to relieve his income tax burden will have to overcome.

The first step has been made and, eventually, there will certainly be more deductions from personal income. For instance, at the end of the very first year that the Law on Personal Income Tax is in force, it has been already proposed to exempt from the personal income tax the expenses of one computer, including the software and (or) internet access, purchased by an individual user per year. This proposal is linked with the latest economic fashion – the creation of the information society. Lithuania is said to be lagging behind by the number of computers, so tax-exempted purchases of computers would facilitate the purchase of computers and increase the consumption of electronic services. There is no doubt - it would really facilitate the purchase of computers. As for the consumption – it would hardly do so, because the tax-exempted computers would probably be bought (to replace the old ones) by those who already use them, and not those who intend to become users. But let's admit that everything not taxed prospers and grows, so we should only appreciate it. However…

However, "the second best" solution is only the second best. It is worse than the former tax-exempted corporate investments, and here is why. First, because based on entirely undefined criteria, people's expenses are divided into income tax-deductible and non-deductible. Some expenses incurred by people become nice and easy, while some other ones, for a certain reason, are doomed to carry the stone-weight of the income tax. Perhaps this is how the state carries out its policies of social support, i. e. that only the poor will not have to pay the personal income tax? Oh no, all the privileged expenses are typical of the people with medium or high income. Will people appreciate such tax relieves? Of course, they will, but not all of them. Not all the people have such expenses because they have more significant needs, and their expenses are taxed. Of course, there will be some people whose decision to purchase a tax-free product will be encouraged by a tax relief. Such a decision will be highly appreciated by the suppliers of such goods or services.

So what would we get in exchange to what? The rule of tax-exempted investments was applied to companies - the ones that are used to deducting expenses, doing accounting, preparing declarations, investing; to companies that are scrupulously inspected, so that all the violations could be easily prevented. The rule of deducting investments was the same for everyone and was applied to any long-term material property. So it was appropriate and the least discriminating. It was not a rule without any faults, of course, but it could have been revised. Sadly, it was abolished, providing a somewhat compensation to the companies instead – a reduced tariff of the corporate profit tax. Are companies happy about the abolished privilege and the lower profit tax rate? Usually not, because it is the Ministry of Finance that is happy with the rate and the increased budget revenues from the corporate profit tax.

What would the new order give to the people? Well, of course, they have been expecting a reduction of the personal income tax rate which is more than twice higher than the corporate profit tax, not to mention the state social insurance fund. In the neighbouring Latvia and Estonia, the personal income tax rates are markedly lower: 25 % in Latvia and 26 % in Estonia. Having abolished the corporate profit tax, Estonia did not stop. Presently, it is carrying out an income tax reform and is planning to reduce the income tax by two percentage points per year, so that the personal income tax was 20 percent by 2006. Everybody agrees on this issue in Estonia, but the neighbouring Swedes call Estonia a small predatory state. The state who applies probably the highest taxes accuses the state who is constantly reducing taxes a predatory one. These are very strange measuring criteria, to say the least. In Lithuania, the reaction to the Estonian tax reform is painful as well, attempts are made to downplay its success, to highlight minor failures or difficulties that nobody can avoid when walking the roads of a new reform.

In Lithuania, the tax rate was reduced for companies, but not for individuals. People really did not want to get entangled with the tiresome income declaration, household bookkeeping, knocking the doors of the Tax Inspectorate and other kinds of bureaucracy. But they will have to if they want to reduce the tax burden and take advantage of the deductions. Yet, not everybody will be able to play on this privilege because the tax relieves are not applied to all the personal expenses or investments. They cannot be applied to all the expenses because that would mean that only the personal savings are taxed, and this would not be logical. The root of the problem is that the very deduction of expenses has been misplaced. People are not enterprises, and not all of them are engaged in commercial activities. A great number of them receive income of just one or two kinds and they want to live without any duties imposed by the government. In other words, a significantly reduced income tax rate would be an optimal solution for both the people and the government. At least the Tax Inspectorate would not need to build a new building in Druskininkai[**] for storing paper income declarations of the residents.

It is very likely that the parliament will make passage for deducting the expenses of purchasing of computers by passing a draft law on personal income tax. And this is welcome, as people in Lithuania will certainly have to get computerised because home bookkeeping is going to become a rather complicated and time-consuming obligation. Just for the sake of the perfection of this proposal, it should be also lawful

[*] The main personal income tax rate is 33%, while the corporate profit tax rate is 15%.

[**] A small town, plaqued by a high level of unemployment, in which a special center for storing paper declarations of Lithuanian residents was built in order to create jobs.

to deduct the expenses for paper, ink and transport or postage tat will be incurred by people who will have to deliver paper declarations about computers purchased to the Tax Inspectorate because declarations submitted electronically are not yet accepted as documents equal to the paper ones. That's right; people will be carrying physically their paper declarations, although they will have all the untaxed possibilities to submit them electronically. This is because today it is the state authorities, not the people, who are badly lacking electronic literacy and informational progress.

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COMMENTS

In the following commentary LFMI's Senior Policy Analyst Ramunas Vilpisauskas doubts whether the payments from the EU budget will have a lasting impact on the country's economy. He believes that more important benefits for Lithuania being in the EU are the institutional reform and a possibility to be heard. The commentary was posted on Lithuania's most popular web portal www.delfi.lt on 18 December, 2003.

...but the EU Funds Are More Important for Lithuania?

By Ramunas Vilpisauskas, Senior Policy Analyst, LFMI

On the weekend of December 12, 2003, a summit of European Union (EU) took place where Lithuania and other future member states participated as well. Although various issues were discussed at this summit, attention was focused on the debates over the EU Constitution. To be more precise, the debate ended before the key issues regarding the reform of the EU institutions and voting procedures were even started to be considered.

It was obvious that the positions of the countries – Poland and Spain – as compared to those of many other countries were overly different. As a result, the governments of the member states did not approve the EU Constitution which was crafted with a view to ensuring a more effective functioning of the EU after the accession of the new members.

We can analyse this unsuccessful attempt at reforming the EU institutions and its consequences to a further development of the EU after its enlargement in various aspects. This commentary will be restricted to one subject – linkages between the Constitution and payments from the EU budget.

Both at the EU intergovernmental conference in autumn 2003 and more recently, the politicians from Germany (who pays the largest contributions into the EU budget) and some other from the richest countries of the EU contemplated the need to trim the EU budget expenditure during a new financial period of the EU after the enlargement (the year 2007-2013).

Taking into account the political background of these contemplations, many analysts did not hesitate to conclude that this was how the larger EU states attempted to push Poland and other countries that were blocking the adoption of the Constitution to approve the Draft Constitution more quickly. To put it in simple words, if you keep being "stubborn" about the provisions of the EU Constitution that narrow down your powers in the EU institutions, you will be punished with smaller benefits from the common budget.

Some analysts also rushed to highlight that many of the EU future members, including Lithuania, kept aside from the "stubborn" Poland just because their feared possible financial sanctions.

It is obvious that any politician of any EU member state would deny such linkages between the EU's institutional reforms and payments from the EU funds. Beside that, the EU payments are allocated on the basis of programs, therefore the funds intended for financing the same goals are usually distributed among various EU states, regions and groups of society.

However, it has been quite explicitly proven that up until now, the EU often remunerated with financial benefits those countries which blocked integration just because they supported specific integration projects. A typical example is an increase of the EU structural funds, the major share of which went to Spain, Portugal and other countries of South Europe for their approval of creating a monetary union. So we should not rule out a possibility that the argument of financial benefits can be exploited not just as a "carrot," but also as a "stick."

In such a case, the main and most relevant question for us is how Lithuanian representatives should act when the discussion evolves around the issues that are important, technical and boring though, for long-term national interests such as voting procedures and when there is a possibility that an overly "stubborn" country may be reminded about the cutting of the EU payments?

In other words, what is more important for us in the EU – benefits from its budget or other things such as, for instance, non-discriminatory participation in the EU's internal market, better representation at the EU institutions and the like?

It seems that until now Lithuanian politicians and diplomats saw the EU funds as the central point regarding the EU, while the rest was of minor importance. The emphases of the EU referendum campaign, Lithuania's participation in the debate about the EU's future priorities and a passive position about the reform of the EU institutions are a glaring comment on that.

Such position is upheld most likely because the non-financial issues (institutional, in particular) are less comprehensible; in addition to that, they are less attractive to voters. Nevertheless, such position is not just economically undefended but it may also have disastrous political consequences.

Let's discuss the economic benefits of the EU funds in the first place. We may justly say that the "EU fund fever," lately prevalent in Lithuania, will sooner or later disillusion a number of entrepreneurs and will be less beneficial for the country's economy than expected altogether. It is not just because probably not all of the EU funds agreed during the negotiations will be appropriated in Lithuania due to the co-financing or, what is even more important, not because of the lack of the ability to write proper projects, implement them and account for them.

The EU funding, in general, has the underestimated effect of distorting business expectations. Currently, a lot of attention and money in Lithuania is allotted focusing on how to "appropriate the EU funds," not on how to develop business and to use the EU funds only as a potential secondary means for solving specific business issues (the lack of qualification, marketing skills, etc.). By the way, only a small share of the funds will be used for business support because one third of the money will go to the agriculture and another big share, to finance the infrastructure and environmental projects.

In economic terms, the supply of the EU funds distort the motivation to invest, which is likely to result in a contracted general return on investments and their benefit to the overall economy of the country. It should be noted that even in those cases when the EU support is provided to the business sector, it is likely to prompt negative side-effects – the distortion of competition. But will those market participants who will manage to get the EU funds and those who won't use them at all will compete on the even playing ground?

Evidently, the benefits of the EU funds are not that obvious as some may think. Of course, those who will take the advantage of this support will enjoy a direct benefit. Yet, the impact on the country's economy and the society is by far unambiguously positive. The EU support would be welcome if it was intended (and actually used) for financing the most needed but unfinished reforms in Lithuania – the reform of education, health care, and social security, as well as for maintaining the internal order. Not for financing short-term goals or supporting the most influential groups of voters and sponsors, but for the reforms that would bring positive long-term results for the entire society. For those areas that some people call public goods and which are usually forgotten as soon as the money is split, or "dividing of the pie" begins. However, for various reasons, the EU funds are not intended for these purposes.

As regards the ambiguous impact of the EU funds, it is difficult to justify the significance attributed to it as compared to the list of Lithuania's interests in the EU. If compared with the issues of the institutional reform that have a long-term impact on the voting power of the country, and the possibilities to be heard, the EU payments often have but a demonstrational and short-lived impact. The EU payments should at best be ranked third among Lithuania's priorities, giving ground to the institutional issues and the possibilities of free trade and movement in the common EU market.

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FEATURE

In the following article LFMI's Vice-president Guoda Steponaviciene analyses the fallacies underlying the knowledge economy, a fashionable movement regarding economic thought. The article was published in a magazine "Naujasis zidinys-Aidai" (2003 No.9).

Knowledge and other economies: 'cherchez l'individu'*

By Guoda Steponaviciene, Vice-president, LFMI

Theory is a dry branch, my brother, many students would say with a sigh. Brain-drying physics, mathematics, economics... But are they really that dry? I am certain that any honest physicist and mathematician would have arguments to defend the vitality of these disciplines.

And what about economics, a science which, on the one hand, is entirely practical, but on the other hand, with pretence to objectivity and precision? An economist is expected to give an assessment of any phenomenon in figures. What will be the growth of economy next year? What should the farmers grow so that they do not need to be subsidised? In what areas should one start a new business? What will be the exchange rate of the dollar in half a year? What could have been the biggest amount for selling the Lithuanian Telecom (in other words: "What was its real value?")? How much should a pharmacy earn on one box of vitamins sold? Where and how much to invest to make an invention which would guarantee wealth and global fame for the country? All these questions are the subject of economics; however, none of them has an answer we expect – precise and objective. Although answers do exist and the knowledge of economics helps us to find them, they can be only hypothetical and subjective.

This gap between the possibilities of economics and the tasks set up for it results in misunderstandings, losses and even crimes. These are the misunderstandings such as five-year-plans, long-term development economic or sector strategies, parliament or government declarations about economic priorities, national agreements, and similar exemplars of wishful thinking embodied in legal acts. Nearly all programme documents both in Lithuania and, particularly, in the European Union are started with Miezelaitis**-style human pathos but end up… in a drawer or losses. When on a large scale, this type of thinking leads to a crime: socialism was based on the assumption that economic activities can be planned and that this can be done by a knowing person – an economist (or a group of them). Apparently, they couldn't.

However, neither a theoretical (L.von Mises, F.von Hayek) nor practical collapse of socialism (right under our own nose thirteen years ago) healed people's temptation to measure up economic solutions, objectively and exactly. There is economic science, sophisticated methods of calculating, mathematical models, foreign experience, statistics, and even artificial intelligence after all!

These things certainly exist. But all of them are at the disposition of a certain individual in a certain place and at certain time, an individual who makes assessments with his own precision and from his own perspective. This acting live individual is the axis around which the paradoxes of the economy turn. If we accept him as the key agent in the economic process, then no pretence to objective and precise knowledge remains, and thus no contradiction. What remains is economics, a science about the activities of individuals that are aimed at achieving material benefits and its methodological key - the motive of an individual or a group of individuals.

But if we, along with Marx or independently, believe that economics is determined by "laws of development of the industrial forces that are objective and free from human will," it is obvious that we do not assign such a role to an acting individual.[2] In that case, the main player is the clever calculator-man, who is detached from a specific place and time and who processes the information held by all other people to

* (*from French*) – "search for an individual"; the rephrased French expression *cherchez la femme* – "search for a woman").

** A famous Lithuanian poet during the Soviet times who created the image of the man-ruler of the world.

[2] K. Marksas. *Kapitalas*, vol. I, Vilnius, 1958.

provide a "scientific" answer. This answer could be fully acceptable as a decision of a single individual; however, the problem is that it has to be executed by other people whose decisions are different. In terms of the economy, it is loss-bringing because when people implement decisions, not best fit for them, resources are distributed ineffectively on the market and the overall welfare decreases. For instance, John buys the same quantity of paint for his house as his neighbour Peter. If the two neighbours' houses are not identical, they will either lack or have too much of the paint. In both cases, it will result in losses.

So why doesn't this contradiction come out in practice? Because people have common sense and paint their houses according to the size of their own house, not the neighbour's. But where the consequences of the decisions are not so glaring, losses don't come into the open. Let's say, it is decided to invest *x* million of taxpayers' money to support agriculture or to establish a technology park. These investments have measurable consequences: an average *y* increase in farmers' income, a *z%* increase in profits of several companies or *q* newly established technology companies. But we do not know, and never will, what would have been the increase of income and profit, and how many new companies would have been established, if this money remained in taxpayers' pockets. If we stick to the opinion that the key player in the economy is the acting individual, we must admit that he will know how the make the best use of his own money.

The issue of calculating and state- or scientific planning in the economy crops up periodically, when a new flag of the economic development is raised. A short time ago, such a flag was the sustainable development (continuous or otherwise "planned in order to be more even"). Its meaning and, most importantly, ways of achieving it did not actually emerge as this flag faded away and was replaced with a proudly sounding "knowledge economy." We should admit that this trademark is a bigger success than the "sustainable development" – at least it can be translated into Lithuanian, although its meaning and ways of implementation remain rather vague.

What is understood by the knowledge economy? Of course, it is computers, telephones, and the Internet. According to the international benchmarking, the more people use these tools, the better: at home, in business, at leisure. But if each person has two mobile telephones and the offices are stuffed with the newest technologies, will that be knowledge economy yet? According to some methodologies of benchmarking, this is exactly how it would be deemed. Yet, something tells us (perhaps that dry branch of theory?) that this is not knowledge economy.

Another popular myth says that the backbone of the knowledge economy is the high-tech industry. Finland and the USA are countries which are seen as models in this respect. Indeed, the Finnish economy is based on the high-tech industry, or, to be more precise, on one company, *Nokia*. This might be very good as regards the knowledge; but it is very risky in terms of the economy. It is like non-diversified investment or playing *va banque*: if everything goes well, the results are very pleasing, but if it doesn't, they are very painful. It is enough to have in mind that high-tech business is riskier than the average business. According to Peter Drucker, even though high technology is in fashion, companies that work in this area account for just a small part of the top lists of the US companies compiled by various analysts. Both the economic growth and new jobs are further generated by so-called old industries. Notably, they embrace more and more areas that earlier were not considered as business, for instance, private health care and education establishments.[3]

The National Agreement (2002) in Lithuania documented the objective that 25% of Lithuania's gross domestic product should be generated by the high-tech industry. Why 25%? As cases in the USA and Finland showed, the more is not the better. The more of the gross product is being generated by one branch of the industry, the graver will be the consequences in case of its recession. The assumption that recessions may be averted should be wiped out from our minds altogether. Building on it would be the same as hoping that the road will always go downhill, the wind will blow from the back and summer will last forever.

And why on earth should it be important that a quarter of the GDP is generated in a specific sector? A hundred litas, earned for wagon loading and producing micro schemes, looks exactly the same and can buy the same amount of goods. The above-mentioned objective can make sense only in two cases: in order to win score in the competition of benchmarking (the "catch-up-with-Estonians" syndrome) and if one believes that technology is a value *per se* (the "man-is-the-conqueror-of-the-world" syndrome). The first approach is typical of the politicians and state officials, the second one – of technocracy. There may be a third motive – the pursuit of high-tech enterprises for exceptional benefits (if not for the company, then at least for the sector), hoping that the state, which has set such objectives, would support or promote companies of this industry. Another postulate of the National Agreement about "the priority industries" suits well with such considerations. By the provided definition, these are the industries with the brightest prospects of development. The priorities, set top-down, are the essence of central planning: then not the market participants - ordinary people - decide where the resources should be channelled, but a certain group agrees on this issue (why is it called the National Agreement then?). The parties of the agreement have not been able to point out the criteria for distinguishing these industries. It is small wonder. Such criteria – objective and precise – do not exist anyway.

The fact of agreement is usually accepted with approval by the society: after all, this is the basis of the democracy. Still, the agreements between certain economic entities (for instance, cartel agreements) or the agreements of economic entities with state institutions (for instance, patronage) are deplorable and even punishable. So what is it that we must agree upon? It is a commonplace but we have to agree upon the rules of the game, not upon who will win or what the score of the game will be.

In terms of the knowledge economy, it would be very sound to agree on the terms, as the knowledge economy is neither high-tech nor a priority industry, nor a branch of the economy in general. The knowledge economy cannot be expressed by the number of computers or mobile telephones per capita or by the number of electronic transactions. The knowledge economy is a qualitative evaluation of the economy which indicates that a large part of the society uses knowledge in their economic activities and in this way responds to the challenges of the changing environment. They use knowledge in the way that seems best for them – maybe automatically or

[3] Drucker, P. F., *Inovation and Entrepreneurship. Practice and Principles*, Oxford: Butterworth-Heinemann, 1985.

maybe not; they may invest into the development of technologies but they may also buy these technologies; they may publish the results of inventions in so-called prestigious publications but they may do it in the Lithuanian magazine *Naujasis Židinys-Aidai* just as well. And even all the economists of the entire world together will not be able to measure these phenomena objectively and accurately.

When discussing the knowledge economy, all gurus of the knowledge economy, having started from macroeconomic stability and telephony level, end with the areas that are much more difficult to measure, for example, education and favourable business environment, cultural habits and the risk level that would be acceptable for the society. US professor Brian Arthur, who has been working in the Silicon Valley for many years, referred to high technology as "deep craft."[4] Michael Porter, when analysing the circumstances of the formation of business clusters, emphasises the importance of the traditions of specific location for the competitiveness of the companies.[5] Drucker sees innovation as the capacity of an acting individual to react to the changing circumstances and systematically use them for the improvement of the economic result, primarily, in management. He believes that economists cannot explain why at the end of the 19th century and lately, apparently, entrepreneurship emerged again, and why it emerged in some countries or cultures, but not in others. Drucker draws the conclusion that the birth of the entrepreneurial economy is both economic and technologic, and cultural and psychological phenomenon, and innovation is an economic-social category, not technological.[6]

All the arguments lead to the conclusion that the knowledge economy (as any other economy) is created or not created by concrete individuals. They create it if they wish, dare and are lucky. When the majority of people in Lithuania will be wishing and daring, even if we are not on the top of the list according to the smart benchmarking, we will rejoice because that will be a sign that the teeth of the soviet mentality got blunt.

[4] Arthur, B. W., *How Growth Builds upon Growth in High Technology. Knowledge Economy Forum*, Helsinki 2003.
[5] Porter, M. E., "Clusters and the New Economics of Competition", in: *Harvard Business Review*, 1998, Nr.11-12.
[6] Drucker, P. F., *op. cit.*

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The Free Market is published by the Lithuanian Free Market Institute – an independent non-profit organisation established in 1990 to advance the ideas of individual freedom and responsibility, free market and limited government. Our motto is

If you don't create a free market, a black market will emerge

The founders of LFMI are – Prof. Kęstutis Glaveckas, Nijolė Žambaitė, Dainius Pupkevičius, Petras Auštrevičius, Elena Leontjeva and Darius Mockus.

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LFMI receives financial support from individuals, corporations and foundations. Devoted to the principles of private ownership, LFMI accepts no funds form the Lithuanian government.

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